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DOW THEORY LETTERS, INC.

"The Market as Interpreted under the Dow Theory"

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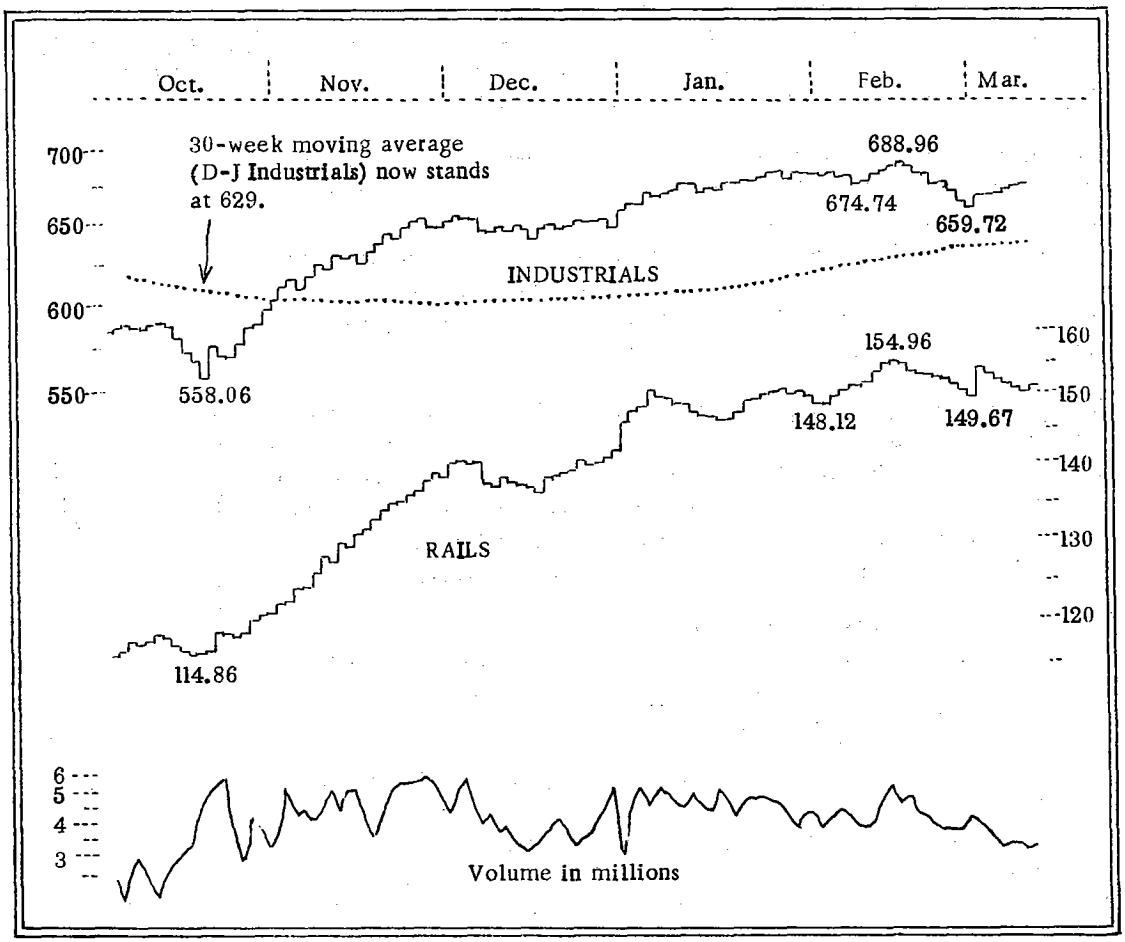
THE MARKET Following the February peaks (see chart), the two Averages sank to March 1 lows of 659.67 (Industrials) and 149.67 (Rails). On March 4 the Supreme Court announced a decision favorable to Rails, and on the news, that Average rose 4.24 points. Over the next five days Industrials pushed higher while Rails declined. Thus, the two indicators diverged for a solid week (indicative of general market indecision). On March 12, however, the two Averages finally got "in gear" on the upside with volume expanding slightly.

As long as one or both Avererages hold above the March 1 lows (i.e., 659.72, 149.67), the situation must be considered favorable for another assault on the February highs. Conversely, a joint penetration of the March 1 lows on increasing volume would indicate that the minor (and perhaps secondary) trend had turned down.

"If the March 1 lows hold, " asks a West Coast subscriber, "do you think the Averages will go to new highs?" I don't know, but if I had to hazard any guess at this time, I would guess that the advance-decline ratio (representative of the trend of the majority of stocks) probably "topped out" a month ago on February 15 (see A-D ratio section in this Letter).

QUESTION: "You have mentioned in recent Letters the importance of the last two low points, 674.74 and 148.12. Since that time both Averages have gone to new recovery highs. I was under the impression that the significance of all previous low points was erased when both Averages went to new high ground. That is the impression I have received over the past, dating from Letter #79." (C. Van Winkle, Yakima, Washington).

ANSWER: It's a pleasure to have the best informed readership in the business. The correspondent is absolutely correct. New recovery highs were established following the 674.74 and 148.12 points, thereby erasing the significance of those levels. The important low points are now 659.72 and 149.67. The error was mine.

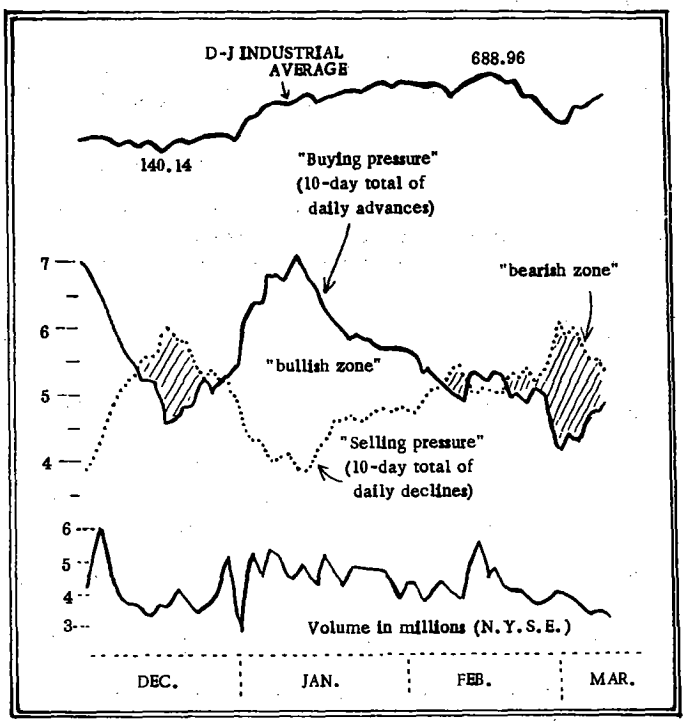


BUYING AND SELLING PRESSURE (a continuous study) During early March the buying pressure line dropped to its lowest level since October, 1962. Selling pressure rose, but note (on chart) that selling pressure advanced only slightly above the level of the December decline. Volume contracted noticeably as the two lines assumed a bearish relationship. Thus, at this writing the graph suggests two things: (1) So far, when a corrective phase hits the

market (i.e., when the selling line rises above the buying line) no liquidating volume has appeared.

(2) The December and the (current) March declines resulted largely from a contraction in buying pressure -- not a rise in selling pressure.

CONCLUSION: The graph has turned negative, but not bearish. A bearish situation would be identified if the selling line rose into the 6.5 to 7 thousand decline range accompanied by rising market volume (or true liquidating pressure).



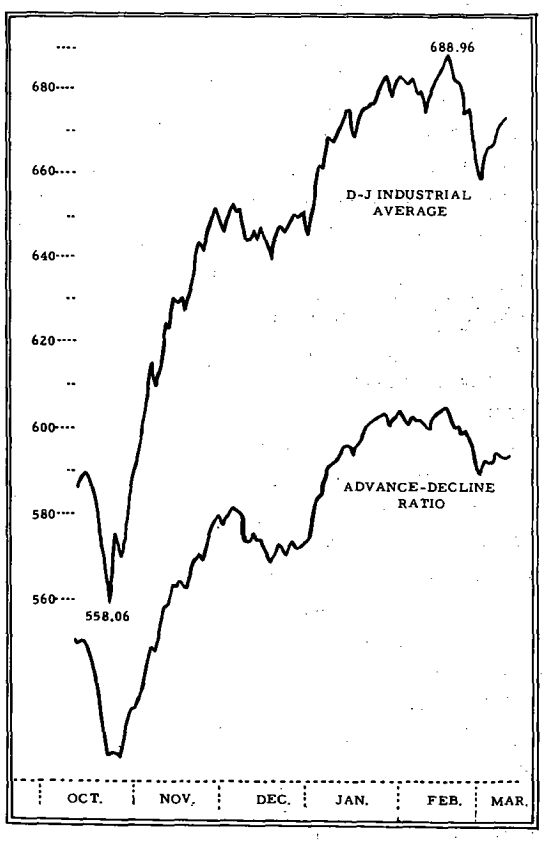
ADVANCE-DECLINES At the February 18, 1963 peak of 688.96, the Industrial Average had retraced 77% of its 1962 crash-losses. The advance-decline ratio recorded its recovery peak on the same day, at which time this indicator had recouped only 54% of its 1962 losses. Thus, at the 1963 highs, the majority of issues had not done as well as the high-grade Dow stocks.

From their February peak of 688.96, Industrials declined to a March 1 low of 659.72. This represents a loss of 19% of the 154 points gained during the 1962-63 recovery (see chart). The decline in the A-D ratio almost exactly matched that of the Industrial Average, and as of the March 1 low the A-D ratio had lost 19% of its 1962-63 gains.

The "classic" danger signal in the price-breadth relationship has always been a second recovery peak in the Industrial Average unconfirmed by the A-D ratio, while a series of two or more recovery peaks in Industrials (unconfirmed by the A-D ratio) has been an almost certain major "sell signal".

However, there have been times in the past when Industrials have advanced for months following a complete "topping out" in the A-D ratio. The last such example was 1959, when the A-D ratio struck a peak in May and the Industrial Average struck its final peak in January, 1960 (seven months later). At other times (and this is particularly true after market crashes), the two indicators have recorded peaks simultaneously. For instance, owners of A-D Ratio Chart Books might turn to the year 1937. During the August rise which followed the 1937 crash, both the A-D ratio and the Industrial Average struck joint peaks (August 14), then turned down. The subsequent collapse has few parallels in market history.

Over the near term, the direction of the A-D ratio and Industrials will bear close watching. If Industrials rise to fresh recovery highs (above 688.96) unconfirmed by new recovery peaks in the A-D ratio, the danger will be patently obvious. On the other hand, joint recovery highs by both indicators will constitute an "all clear signal". If both indicators continue their downward path, then there will have been nothing in the breadth-price relationship that pointed to trouble ahead.



SUNDRY (PERSONAL) COMMENTS A subscriber writes: "I cashed in 2,000 shares of Dome Mines at 'the top' in July, 1962, for a net profit of $8,000.00. I sold my other stock holdings in April, 1962, before the Dow bear confirmation; bought them back in early November -- and am now 100% in cash. It hasn't been easy, and the market has been too much of a strain lately. I'm taking a rest with my money in the bank. (G. S., Las Vegas, Nevada).

If my Las Vegas subscriber has done anything wrong, I can't uncover it. I reprint an excerpt from his letter because it illustrates one important point -- right or wrong, the average investor is tired. And if investors are tired, the public is undoubtedly exhausted.

The market collapse of 1962 broke the back of the great "growth syndrome" and left investors and the public holding an assorted collection of "glamour stocks", "science issues" and "new issues" which, at the 1962 lows, showed losses of from 50% to 90%. Moreover, at and around the 1962 lows it is probable that these same shares went (writes Brad Thurlow of New York) "...from weak hands into other weak hands." Suffice it to say that the

majority of 1959-61's "hot issues" have never come back again.

Over the past six months investors and traders have marched the thirty Dow Industrial stocks up to the 680-690 level (and the 3.5% average yield zone), and they are now waiting for the much talked about "second entrance of the crowd". As another market service (wistfully) put it this week: "... "So far there has been no 'mark-up' stage -- the stage in which the public runs the price up for the benefit of that informed and well-moneyed majority that accumulated in the first stages. This is a good bullish argument."

It may be a good bullish argument, but I will again remind subscribers that the market recoveries following the crashes of '29, '37 and '46 ended amid odd-lot selling. The crowd did not become bullish again.

* * * * * *

Letter 211 suggested that in the face of mounting resistence to tax cuts, our Administration would probably resort to a program of "fear". That program is now in "high gear". On March 7 Labor Secretary Wirtz announced that unemployment had risen to 6.1%. The Wall Street Journal noted that Mr. Wirtz "...called on Congress to enact the President's tax-cut reform measures." Furthermore, said the Journal, Mr. Wirtz warned that "...unemployment can be expected to increase in the coming months unless Congress acts quickly on the President's proposals to "shift the economy into high gear'."

Secretary of the Treasury Dillon is also getting into the act. Last week he announced that tax cuts can play "a major role" in reducing the balance of payments. His reasoning: tax cuts will bring about an expansion in business; the expansion will bring about higher interest rates; the higher interest rates will attract dollars to our shores. (Comments are superfluous).

* * * * * *

If the Industrial Average rises to a new high (above 698.96), it will have traced a perfect "broadening formation" (see chart on bottom of page 2). Such formations are decidedly bearish, and I will discuss this in detail if and when new highs are reached.

IN THE PRICE A subscriber recently asked me the following question: "Taking all the much-talked-about 'indicators', the technical studies, the short interest ratio, odd-lots, low-priced stock indices, etc., what studies do you consider the most important of all? In other words, if you were reduced to say two or three sets of market statistics daily, which ones would you choose?"

My answer was that I would choose the studies having to do with price movement and volume. In my experience, I have found that the studies least likely to "go haywire" and most likely to tell "the true story" are those dealing with the price movement and the volume of transactions. These include the basic study of the Averages and volume (i.e., the Dow Theory), the Advance-Decline statistics (i.e., what the entire market is doing), and the studies of individual stocks (i.e., what the units that make up the market are doing). A veteran who has spent half a century studying every phase of the market once told me: "If it doesn't have to do with price, beware of it. Everything is in the price movement -- everything!"

I have been suspicous of the entire 1962-63 advance. The manner in which the recovery began, the patterns which stocks assumed as they advanced, the volume indications, the pattern of the Averages, all these things "bothered me", and I have offered numerous comments in each of these catagories as the recovery continued.

One basic phenomenon which I have not discussed before is worth taking up at this time. This is what I call the "channel principle" for want of a better name. One of the great mysteries of technical analysis is the observation that stocks tend to rise and fall along straight lines or trendlines (and this is particularly obvious if stock movements are charted on semi-logarithmic scale). Normally, a bull movement will progress for a certain length of time -- then react. If a trendline is drawn connecting the extreme bottom and the reaction bottom (trendline marked A on the accompanying charts), we will then have traced the primary or at least the intermediate upward trend.

Next, a trendline passing through the first peak and parallel to the first trendline is drawn (this is shown as trendline B on charts). In a strong bull movement, the second upward leg (marked X) following the first reaction should rise and touch or surpass the upper trendline (B). However, if the second rise fails to make contact with trendline B (particularly if volume falls off on the rise) we have a fairly reliable warning of trouble ahead.

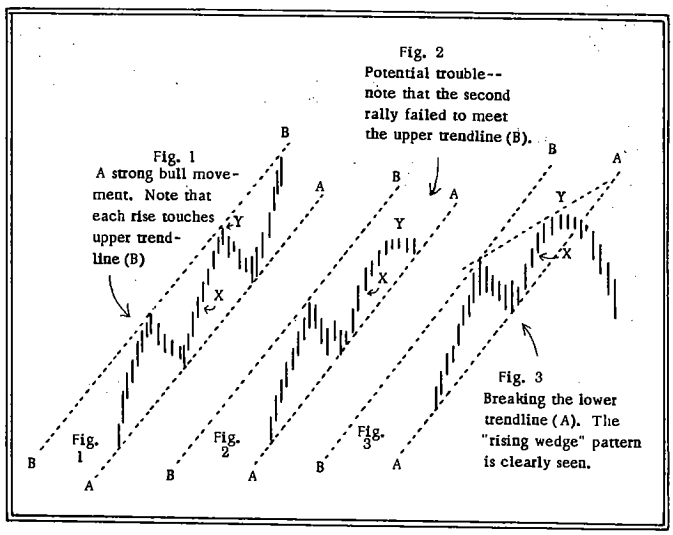
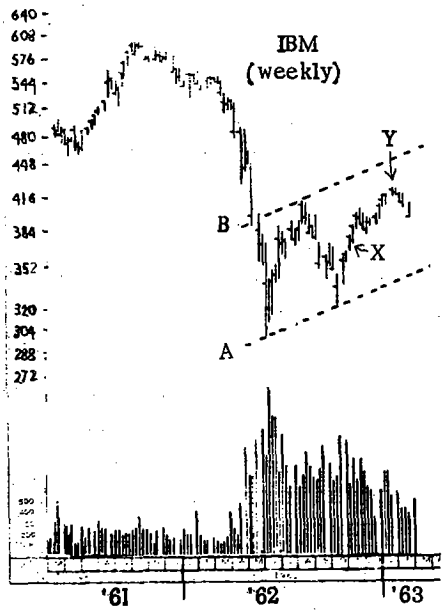


Fig. 1
A strong bull movement. Note that each rise touches upper trendline (B)
Fig. 2
Potential trouble-- note that the second rally failed to meet the upper trendline (B).
Fig. 3
Breaking the lower trendline (A). The "rising wedge" pattern is clearly seen.
Fig. 1
Fig. 2
Fig. 3
A
B
X
Y

Note (on the accompanying charts) that in each case the second peak (at Y) failed to touch the upper trendline (B). In each instance volume was receding as prices neared Y; following this failure of price and volume the stock turned down.

The next test is as follows: will the decline from point Y hold above the original rising trendline (A). If the lower trendline (A) is violated, this constitutes an important reversal. In the case of Avco, the main rising trendling has been penetrated, and these stocks must therefore be taken as having turned bearish. Although the first warning has appeared in the chart of Kaiser and IBM, the tre ndline A has not yet been violated. Thus, Kaiser and IBM will face a critical test in the weeks ahead.

Note that the failure to meet the upper trendline has, in each case, produced a formation in which two rising trendlines have converged to form an up-slanting triangle. This is actually the "rising wedge" which has been discussed in previous Letters. The rising wedge denotes a situation in which "customer interest" or buying power is slowly but persistently diminishing. The rising wedge is essentially a bear market formation. The decline in the price movement following the breaking of a rising wedge is often of major proportions. The writer notes that a great many stocks have now formed rising wedge patterns, suggesting that the recovery is rapidly running into trouble. My own guess is that the majority of stocks on the Board have "topped out" of the 1962-63 rise.



STOCKS Of 350 representative stocks which are watched carefully at this office, 228 (64%) are now holding above their 30-week moving average (no change from last week) and 171 (49%) are now above their 1962 recovery highs (a rise of 4% from last week).

Stock groups showing strongest relative strength are food products, farm equipment, autos and rails. Weakest groups are aircraft, building supply, steels and tobaccos. The rail equipment group is beginning to show signs of strength. Rail equipment stocks worth watching are American Brake Shoe, N.Y. Air Brake, Westinghouse Air Brake and that speculative, perpetual "low-priced stock", Baldwin-Lima-Hamilton (see chart of Baldwin below).

LATE NOTES Written Wednesday, March 13, 1 P.M., N.Y. time). Both Averages are pushing higher today with volume expanding noticeably. This could well be the "try for the highs" alluded to on page 1.

Charts on this page courtesy of Traders Research, P. O. Box 2466, St. Louis 16, Missouri